

law employee, the basis for the retirement bond is presumed to be the amount of the purchase price which the retirement bond indicates was contributed by the employee.

(3)(i) Except as provided in subdivision (ii) of this subparagraph, for purposes of determining the basis of retirement bonds purchased for an individual while he was a self-employed individual, all such bonds redeemed during a taxable year shall be considered in the aggregate as a single retirement bond. The basis of such retirement bonds shall be the difference between the aggregate of their face amounts and the lesser of:

(A) 1 One-half the aggregate of their face amounts, or

(B) The aggregate of the unused amounts allowed as a deduction at the end of the taxable year (as determined in subparagraph (4) of this paragraph).

(ii) The basis of a retirement bond purchased for a self-employed individual which is redeemed after his death is the amount determined by multiplying the face amount of such retirement bond by a fraction—

(A) The numerator of which is the aggregate of the face amounts of all the bonds registered in the individual's name at his death which were purchased while he was a self-employed individual reduced by the aggregate of the unused amounts allowed as a deduction at his death (as determined in subparagraph (4) of this paragraph), and

(B) The denominator of which is the aggregate of the face amounts of all such bonds.

(4)(i) In the case of retirement bonds purchased under a qualified bond purchase plan, the aggregate of the unused amounts allowed as a deduction at the end of any taxable year shall be an amount equal to the total of the amounts allowable for such taxable year, and the amounts allowed in all prior taxable years, as a deduction under section 405(c) for contributions used to purchase retirement bonds for the registered owner while he was a self-employed individual, reduced by an amount equal to the portion of the face amounts of such retirement bonds redeemed in prior taxable years which

were included in the registered owner's gross income.

(ii) In the case of retirement bonds purchased by a trust described in section 401(a) and exempt under section 501(a), there shall be allocated to the retirement bond the deduction under section 404 attributable to the contributions used to purchase the retirement bond. The amount so allocated shall be treated in the same manner as the deduction allowed under section 405(c) for purposes of computing the unused amounts allowed as a deduction under subdivision (i) of this subparagraph. Further, the amount so allocated shall not be included in the investment in the contract for purposes of section 72 in determining the portion of the other assets distributed by the trust included in gross income.

(5) The application of the rule of subparagraphs (3) and (4) of this paragraph may be illustrated by the following examples:

*Example (1).* B, a self-employed individual, adopts a qualified bond purchase plan in 1963. During 1963 the plan purchased \$2,000 worth of retirement bonds in his name. As a result of overestimating his income for 1963, only \$400 was allowed B as a deduction pursuant to section 405(c). In 1964, prior to B's retirement in June of that year, the plan purchased a \$500 retirement bond in B's name for which a deduction was allowable pursuant to section 405(c) in the amount of \$250. B redeemed a retirement bond with a face amount of \$500 in September of 1964 and another with a face amount of \$500 in October of 1964. Of the proceeds received in 1964 from the redemption of the bonds, \$1,000 plus interest, B shall exclude from his gross income \$500 (face amount of the retirement bonds, \$1,000, less \$500, one-half of the face amount, the latter being less than the aggregate of the unused amounts allowed as a deduction, \$250 allowable for the taxable year in which the bonds were redeemed plus \$400, the unused amounts allowed in prior taxable years, or \$650). The aggregate of the unused amounts allowed as a deduction shall be reduced by the amount so excluded (\$650 - \$500 = \$150). During the following year, B redeems another retirement bond with a face amount of \$500. Of the proceeds received from the redemption of such retirement bond, \$500 plus interest, B shall exclude from his gross income \$350 (face amount of the retirement bonds, \$500, less \$150, the aggregate of the unused amounts allowed as a deduction, the latter being less than one-half of the face amount of the bond, \$250). The aggregate of the unused amounts allowed as a

deduction is reduced to zero (\$150-\$150=0). Upon redemption of the remaining retirement bonds registered in B's name, B shall exclude from his gross income with respect to such proceeds an amount equal to the face amounts of the bonds redeemed.

*Example (2).* C, a self-employed individual, participated in a qualified bond purchase plan during the years 1963 through 1966. The plan purchased in his name retirement bonds in the aggregate of \$10,000. C deducted \$4,000 from his gross income for the four years (\$1,000 for each year) with respect to the purchase of such retirement bonds. C retired in December of 1966 and during the following year redeemed one retirement bond with a face amount of \$1,000. C excluded from his gross income \$500 of the proceeds of the bond. C died without redeeming any of the remaining retirement bonds registered in his name. The basis of each remaining retirement bond shall be determined by multiplying the face amount of each retirement bond by  $\$5,500 \div \$9,000$ . The numerator is the aggregate of the face amounts registered in C's name (as a self-employed individual) at his death, \$9,000, reduced by the aggregate of the unused amounts allowed as a deduction at his death, \$3,500 (amounts allowed as a deduction under section 405(c), \$4,000, reduced by the portion of the face amount of the retirement bond redeemed by C which was included in C's gross income, \$500), or \$5,500. The denominator is the face amount of the retirement bonds registered in his name as a self-employed individual at his death, \$9,000.

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**§ 1.406-1 Treatment of certain employees of foreign subsidiaries as employees of the domestic corporation.**

(a) *Scope*—(1) *General rule.* For purposes of applying the rules in part 1 of subchapter D of chapter 1 of subtitle A of the Code and the regulations thereunder with respect to a pension, profit-sharing, or stock bonus plan described in section 401(a), an annuity plan described in section 403(a), or a bond purchase plan described in section 405(a), of a domestic corporation, an individual who is a citizen of the United States and who is an employee of a foreign subsidiary (as defined in section 3121(l)(8) and the regulations thereunder) of such domestic corporation shall be treated as an employee of such domestic corporation if the requirements of paragraph (b) of this section are satisfied.

(2) *Cross-references.* For rules relating to nondiscrimination requirements and

the determination of compensation, see paragraph (c) of this section. For rules under which termination of the status of an individual as an employee of the domestic corporation in certain instances will not be considered as separation from service for certain purposes, see paragraph (d) of this section. For rules regarding deductibility of contribution, see paragraph (e) of this section. For rules regarding treatment of such individual as an employee of the domestic corporation under related provisions, see paragraph (f) of this section.

(b) *Application of this section*—(1) *Requirements.* This section shall apply and the employee of the foreign subsidiary shall be treated as an employee of domestic corporation for the purposes set forth in paragraph (a)(1) of this section only if each of the following requirements is satisfied:

(i) The domestic corporation must have entered into an agreement under section 3121(l) to provide social security coverage which applies to the foreign subsidiary of which such individual is an employee and which has not been terminated under section 3121(l)(3) or (4).

(ii) The plan, referred to in paragraph (a)(1) of this section, must expressly provide for contributions or benefits for individuals who are citizens of the United States and who are employees of one or more of its foreign subsidiaries to which an agreement entered into by such domestic corporation under section 3121(l) applies. The plan must apply to all of the foreign subsidiaries to which such agreement applies.

(iii) Contributions under a funded plan of deferred compensation (whether or not a plan described in section 401(a), 403(a), or 405(a)) must not be provided by any other person with respect to the remuneration paid to such individual by the foreign subsidiary.

(2) *Supplementary rules.* Subparagraph (1)(ii) of this paragraph does not modify the requirements for qualification of a plan described in section 401(a), 403(a), or 405(a) and the regulations thereunder. It is not necessary that the plan provide benefits or contributions for all United States citizens who are employees of such foreign subsidiaries. If the plan is amended to cover individuals

who are employees by reason of paragraph (a)(1) of this section, the plan will not qualify unless it meets the coverage requirements of section 410(b)(1) (section 401(a)(3), as in effect on September 1, 1974, for plan years to which section 410 does not apply; see § 1.410(a)-2 for the effective dates of section 401) and the nondiscrimination requirements of section 401(a)(4). In addition, the administrative rules contained in § 1.401(a)-3(e) (relating to the determination of the contributions or benefits provided by the employer under the Social Security Act) will also apply for purposes of determining whether the plan meets the requirements of section 401. For purposes of subparagraph (1)(iii) of this paragraph, contributions will not be considered as provided under a funded plan merely because the foreign subsidiary is required under the laws of the foreign jurisdiction to pay social insurance taxes or to make similar payments with respect to the wages paid to the employee.

(c) *Special rules*—(1) *Nondiscrimination requirements.* For purposes of applying sections 401(a)(4) and 410(b)(1)(B) (section 401(a)(3)(B), as in effect on September 1, 1974, for plan years to which section 410 does not apply) and the regulations thereunder (relating to nondiscrimination concerning benefits and contributions and coverage of employees) with respect to an employee of the foreign subsidiary who is treated as an employee of the domestic corporation under paragraph (a)(1) of this section—

(i) If the employee is an officer, shareholder, or (with respect to plan years to which section 410 does not apply) person whose principal duties consist in supervising the work of other employees of the foreign subsidiary of the domestic corporation, he shall be treated as having such capacity with respect to the domestic corporation; and

(ii) The determination as to whether the employee is a highly compensated employee shall be made by comparing his total compensation (determined under subparagraph (2) of this paragraph) with the compensation of all the employees of the domestic corporation (including individuals treated as employees of the domestic corporation

pursuant to section 406 and this section).

(2) *Determination of compensation.* For purposes of applying section 401(a)(5) and the regulations thereunder, relating to classifications that will not be considered discriminatory, with respect to an employee of the foreign subsidiary who is treated as an employee of the domestic corporation under paragraph (a)(1) of this section—

(i) The total compensation of the employee shall be the remuneration of the employee from the foreign subsidiary (including any allowances that are paid to the employee because of his employment in a foreign country) which would constitute his total compensation if his services had been performed for the domestic corporation;

(ii) The basic or regular rate of compensation of the employee shall be determined for the employee in the same manner as it is determined under section 401 for other employees of the domestic corporation; and

(iii) The amount paid by the domestic corporation which is equivalent to the tax imposed with respect to the employee by section 3101 (relating to the tax on employees under the Federal Insurance Contributions Act) shall be treated as having been paid by the employee and shall be included in his compensation.

(d) *Termination of status as deemed employee not to be treated as separation from service for purposes of capital gain provisions and limitation of tax.* For purposes of applying the rules, relating to the treatment of certain distributions which are made after an employee's separation from service, set forth in section 72(n) as in effect on September 1, 1974 (with respect to taxable years ending after December 31, 1969, and to which section 402(e) does not apply), and in sections 402(a)(2) and (e) and 403(a)(2) with respect to distributions or payments made after December 31, 1973, and in taxable years beginning after December 31, 1973) with respect to an employee of a foreign subsidiary who is treated as an employee of a domestic corporation under paragraph (a)(1) of this section, the employee shall not be considered as separated